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Should Surplus Prices Be Increased In Midwest Federal Milk Order Markets?

Excerpts from a talk by H. L. Forest, Director Dairy Division at University of Wisconsin, Madison, Wisconsin, January 29, 1960

The question "Should surplus prices be increased in Midwest Federal order markets?" is so broad it would require far more time than we have here today if I were to discuss all of its aspects. I plan to limit my talk, therefore, to the kind of problems which arise in pricing Class IV milk in the Chicago market.

Class IV, as defined in the Chicago Federal order, is the class which includes milk used in manufacturing cheese and in making butter and nonfat dry milk. These products are sold on national markets. That means the prices which processors can obtain for such products are subject to nationwide competition.

There is little that an individual milk processor or dairy products manufacturer can do to influence the price which he receives for his products when they are sold on a national market or in competition with other processors who sell on a national market. He might get a premium for extra quality or special packages but his basic price is determined by competition in the broad national market.

We are directed in establishing prices under Federal milk orders to establish prices which will attract an adequate but not excessive supply to the market. Since handlers of surplus milk, which is a natural and necessary part of every fluid milk market, exhibit willingness or reluctance to handle such milk according to the margin available to them, it is important that the margin neither deter them from taking the necessary surplus nor encourage them to acquire supplies in excess of that necessary quantity.

A low price for surplus milk relative to product prices increases processors' margins and makes handlers who have facilities for manufacturing milk eager to acquire more milk for manufacturing. They may institute vigorous programs to expand their receipts from producers. At the same time, they will be reluctant to relinquish supplies to handlers who need milk for fluid sales without exacting margins equivalent to those obtainable from manufacturing operations.

If the surplus price is too high handlers will be reluctant to accept milk in excess of fluid sales. This may create a "tight" market and handlers who do not carry their own reserves may be forced into paying high "spot" prices for supplemental supplies of milk. A general increase in the price paid for supplemental milk could bring higher Class I prices for regular supplies as handlers adjust their buying plans to the relative price levels.

One of the most important determinants in unit costs is volume of operations. In most lines of economic activity in recent years the effect of volume has been a dominant factor in determining unit costs. The trend to large scale in dairy plants as well as on dairy farms has received impetus from the desire to increase earnings by lowering unit costs.

If the efficiency of milk processing plants has increased generally in the Chicago area it is possible that the present formula for pricing surplus milk is not reflecting the true value of such milk. If that is the case, what are the results of such underpricing?

In the first place milk producers, except those who operate their own manufacturing plants, are underpaid for their milk when surplus prices are too low. Producers who are members of cooperatives which handle surplus milk gain in their dividend returns what they lose in underpayments. Other producers do not have this opportunity to recover such losses. Thus the pattern of uniform prices to producers is removed.

The lack of uniformity in prices affects handlers as well as producers. Handlers who manufacture milk and enjoy wide margins as a result of low surplus milk prices have an advantage over fluid milk distributors who do not enjoy the same advantage. Handlers who have both fluid sales and manufacturing operations may be encouraged under such circumstances to expand manufacturing at the expense of their fluid business.

(continued on the back page)

Columbus Market Facts

MARKET FACTS FOR EASY REFERENCE

	Feb. 1960	Jan. 1960	Feb. 1959
PRICE SUMMARY			
Producers' Uniform Price (3.5%)	$4.28	$4.46	$4.34
Producers' Uniform Price (4%)	4.66	4.845	4.70
Class I (3.5%)	4.508	4.685	4.44
Class II (3.5%)	4.108	4.285	4.04
Class III (3.5%)	3.742	3.777	3.94
Class IV (3.5%)	2.993	2.996	2.869
Producer Butterfat Differential for each 1/10%	.076	.077	.072
UTILIZATION SUMMARY			
Percent of Producer Milk in Class I	80.9	83.2	86.4
" " " B.F. " " I	74.9	76.5	82.2
" " " Milk " " II	7.2	6.3	10.7
" " " B.F. " " II	2.1	1.9	3.1
" " " Milk " " III	2.2	2.1	.8
" " " B.F. " " III	3.1	3.1	3.0
" " " Milk " " IV	9.7	8.4	2.1
" " " B.F. " " IV	19.9	18.5	11.7
PRODUCTION SUMMARY			
Total Pounds of Producer Milk Delivered	27,057,916	28,244,823	21,909,063
Average Daily Class I Producer Milk	754,873	758,297	676,374
Total Number of Producers	1,703	1,696	1,689
Average Daily Production per Producer	548	537	463
Average Butterfat Test	3.93	3.96	3.85
Total Value of Producer Milk at Test	$1,244,615.52	$1,357,600.18	$1,006,507.14
Income per Producer (7 Day Average)	$176.41	$180.75	$148.98
GROSS CLASS USE (Pounds)			
Class I Skim	21,095,114	22,652,068	18,244,360
" I B.F.	796,194	855,154	694,124
" I Milk	21,891,308	23,507,222	18,938,484
" II Skim	1,965,777	1, 832, 927	2,343,045
" II B.F.	22,827	21,617	25,890
" II Milk	1,988,604	1,854,544	2,368,935
AVERAGE DAILY SALES (Quarts)			
Milk	305,249	297, 564	274,936
Buttermilk	5,188	4,953	5,056
Chocolate	16,690	16,469	14,603
Skim	12,505	11,818	11,080
Cream	8,765	8,580	8,025

*Fall production payment 51 cents per cwt. additional

COMPARATIVE STATISTICS ★ **COLUMBUS MARKETING AREA** ★ Feb., 1951-60

Year	Receipts from Producers	Average Butterfat Test	Percentage of Producer Milk in Each Class				Uniform Producer Price (3.5%)	Class prices at 3.5%				Number of Producers	Daily Average Production
			Class I	Class II	Class III	Class IV		Class I	Class II	Class III	Class IV		
1951	15,420,477	4.14	80.1	16.8	3.1	——	4.80	4.942	4.542	3.451	——	2,124	259
1952	16,151,739	4.07	83.6	14.7	1.7	——	5.37	5.454	5.054	4.278	——	2,103	265
1953	18,732,785	4.03	76.5	15.2	8.3	——	4.50	4.662	4.262	3.586	——	2,228	300
1954	21,690 415	3.96	71.0	13.0	16.0	——	4.13	4.34	3.94	3.46	——	2,238	346
1955	21,417,170	3.94	77.1	8.1	7.1	7.7	4.02	4.23	3.83	3.83	3.154	2,132	359
1956	23 832,175	3.89	75.7	9.8	6.9	7.6	3.91	4.094	3.694	3.694	3.118	2,074	396
1957	21,646 895	3.80	85.7	8.7	2.9	2.7	4.44	4.529	4.129	4.029	3.063	1,921	402
1958	22,305,961	3.86	83.9	9.6	3.1	3.4	4.38	4.504	4.104	4.003	3.082	1,844	432
1959	21,909 063	3.85	86.4	10.7	.8	2.1	4.34	4.44	4.04	3.94	2.869	1,689	463
1960	27,057,916	3.93	80.9	7.2	2.2	9.7	4.28	4.508	4.108	3.742	2.993	1,703	548

Volume of Price Support Purchases Declined in 1959

Production of milk on a per capita basis has declined rather sharply along with the decline in demand for milk products, measured on a milkfat solids basis. Production per person was 703 pounds in 1959, 793 pounds in the 1947-49 period, and over 800 pounds prior to World War II. This drop has tended to lessen the excess of supply over demand at support levels. In the first 10 months of this marketing year which ends March 31, 1960, the milk equivalent (milk fat basis) of 2,280 million pounds was sold to the Government, compared with 2,640 million pounds a year earlier. Sales to the Government totaled 3,434 million pounds in the entire 1958-59 marketing year and 6,818 million pounds in 1957-58. Purchases in the current marketing year likely will be only a little over 2 percent of production, compared with 2.8 percent in the 1958-59 marketing year and 5.3 percent in 1957-58.

The trend toward a balance between commercial demand and supply has been much more pronounced in the case of milkfat than for milk solids-not-fat. In the last marketing year, 2.8 percent of the milkfat was sold to CCC under the price support program, compared with 8.2 percent of solids-not-fat produced. The quantity of nonfat dry milk removed from the market under the dairy support program from April 1959 through January 1960 of the current marketing year was about the same as a year earlier. Total purchase contracts for nonfat dry milk in bulk and small containers was only 578 million pounds compared with 719 million pounds. But the scheduled deliveries to USDA were 673 million pounds from April through January in 1959-60 and 668 million pounds a year earlier. With farmers selling an increased proportion of their output of milk solids-not-fat, production of nonfat dry milk in 1960 as a whole probably will at least equal that of a year earlier. Sales of this item to CCC were seasonally small last fall. CCC sales to commercial exporters (at reduced prices) were heavy; supplies in the hands of CCC were exhausted temporarily, and it was necessary to terminate both foreign donation and sales. Sales to CCC increased seasonally from November to January. Supplies of this item were made available again for foreign distribution under Title II of P. L. 480. Beginning in February, supplies were offered for export on a competitive bid basis.

Prices for Milk Products Declined the Second Half of December 1959

The domestic supply-demand situation for dairy products in total improved in 1959 as milk output declined slightly, and total commercial sales increased. The seasonal decline in milk output during the second half of 1959, as demand held constant or increased slightly, led to the termination of sales of butter and cheese to the Government under the price support program, and a seasonal decrease in sales of nonfat dry milk. This led to substantial increases in prices for butter, cheddar cheese, and fluid cream and to smaller increases for a number of other dairy products. The price increases of butter and cream above the equivalent of support levels were the largest since 1952, although the actual levels were well below 1952. The downward adjustment in prices came rapidly, following the seasonal increase in milk output beginning in December 1959. By early January, prices of butter were back to the equivalent of support levels, and significant quantities of butter were being sold to the CCC. Sales of butter and nonfat dry milk to the Department rose considerably above a year earlier. Meanwhile the price of cheddar cheese continued well above the CCC support buying price during January and this helped to keep up the average price of manufacturing milk. As of January 1960, prices received by farmers for all milk at wholesale, manufacturing milk and butterfat were one to two percent above a year earlier. With milk production likely to expand before the end of 1960 it is quite possible that the excess of supply over demand at support levels will increase within the next year or so.

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Should Surplus Prices . . .

(continued from page one)

Attractive margins on surplus milk are dangerous to the orderly marketing function of the classified pricing plan. They tend to attract milk away from the fluid market rather than toward it.

In many recent months premiums paid by Chicago handlers above minimum Class I prices have increased such prices without affecting the price of surplus milk. Unless the payment of premiums is rigidly required of all handlers, however, lack of uniformity among handlers in the cost of Class I milk may result from such voluntary premiums.

The premium payments on Class I and Class II in the Chicago market can be readily passed on to consumers since the majority of handlers competing for sales of milk in such uses have agreed to pay the premium. However, the premium payment on Class IV must be absorbed by processors since the prices they receive for manufactured dairy products are subject to nationwide competition. Therefore, the 10-cent premium on Class IV milk will probably be fully reflected in lower margins available to manufacturing operators.

The basic question to be answered under these circumstances relates to whether Federal milk orders can maintain orderly marketing of milk in these markets without a pattern of Government-regulated effective prices.

There is also the question of whether Government regulation is necessary. Milk producers cooperatives have grown in strength particularly within the past decade. On the other hand, the marketing problems with which milk producers must deal have also grown in seriousness and complexity.

It would appear that producers believe Federal assistance is necessary in their marketing program. The proportion of all milk sold by farmers which is marketed under Federal orders has been increasing rapidly. Last year the total volume priced under Federal orders reached 40 billion pounds, 40 percent of all milk sold wholesale by farmers.

In seeking Federal milk orders and in requesting their continuance it is important that producers keep in mind the purpose for which such orders are issued. Federal orders under some other type of regulation might be issued for different purposes but orders today must be administered under present legislation.

The Agricultural Marketing Agreement Act requires that minimum prices be established at levels which will assure an adequate but not excessive supply of milk for the market. The Act's declared purpose is the maintenance of orderly marketing which is accomplished by the uniform application of such minimum prices to all handlers.

Continuous and intensive study of market conditions and prices in each area is necessary to assure that the purposes I have mentioned are effectuated. That study is best carried out by persons in each market who have a direct interest in milk marketing in that area.

It is not a question to which there is a simple answer and I have not attempted to develop a "Yes" or "No" answer. I have endeavored to illustrate the importance of the question and describe the public interest in the answer.

Market Quotations

Feb. 1960

12 MIDWEST CONDENSERIES 3.5% per Cwt.	$3.119
5 CONDENSERIES (Cincinnati) 3.5% per Cwt.	2.97
5 CONDENSERIES (North Central Ohio) 3.5% per Cwt.	2.998
2 CONDENSERIES (Toledo) 3.5% per Cwt.	2.931
4 CONDENSERIES (Tri-State) 3.5% per Cwt.	3.056
Evaporated Milk Code Price, 3.5% per Cwt.	2.803
Skim Milk Powder-Butter Price, 3.5% per Cwt. (Cincinnati)	3.0619
Skim Milk Powder-Butter Price, 3.5% per Cwt. (Columbus)	3.043
Skim Milk Powder-Butter Price, 3.5% per Cwt. (Dayton)	3.067
Skim Milk Powder-Butter Price, 3.5% per Cwt. (Toledo-Tri-State)	2.941
Average Weekly Cheddars price per lb.	.3475
Average price per lb. non-fat dry milk solids, roller process delivered Chicago	.13862
Average price per lb. 92-score butter at Chicago	.57976
Average carlot prices non-fat dry milk solids, roller and spray process, f.o.b. manufacturing plant	.13205